National Association of Public Pension Attorneys
Legal Education Conference
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(Bill Holahan)

**New Attorney Sessions**

- **Fiduciary Relationships –** Fiduciary considerations should be the guiding principle behind the actions of the Board of Trustees, both individually and collectively. The primary duty of a pension fund lawyer is to ensure that the trustees fulfill their fiduciary responsibilities and obligations to the members, retirees, and beneficiaries of the retirement system. The duty of care requires trustees to act with care, skill, and prudence exercised by similar fiduciaries in investment-related matters, including diversification of investments. Fiduciary relationships are created and defined under the following areas of law:
    - Law of Trust – Restatement of Trusts (Third), 1992.
    - By Contract
    - By Statute – Federal Statutes – ERISA, 1974, Uniform Prudent Investors Act (UPIA), 1994. Uniform Management of Public Employees Retirement Systems Act (UMPERSA), 1997.
    - Retirement Plan enabling statutes
    - State statutes, local ordinances.

- **Considerations For Defined Benefit Plans** – There are several points a new practitioner must be aware of when providing legal advice to assist with the administration of a defined benefit plan, these areas include:
    - Federal Laws Affecting Government Plans
    - State Laws Affecting Benefits Administration
    - Exemption from many Federal Law Requirements
    - Calculating Retirement Allowances in a Traditional Defined Benefit Plan
    - Dealing with Errors in Administration of Benefits
- Relevant Federal laws affecting government plans include:
    - **Contract Clause** – Article I § 10 clause 1 of the United States Constitution states "No State shall pass any . . . Law impairing the Obligations of Contracts." Most states, but not all, have general contract clauses that are analogous to the federal Contract Clause. The majority approach is that pension benefits are contractual in nature.
    - **Internal Revenue Code** - If the Plan intends to be a "qualified plan" under Section 401(a) of the Internal Revenue Code ("IRC"), in order to enjoy tax exempt status under IRC § 501(a), the Plan must meet many IRC requirements. However, governmental plans are also exempt from many of the IRC requirements that apply to non-governmental plans.
    - **ERISA** - Governmental plans are exempt from most key provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"): (1) Title I of ERISA which deals with mandatory requirements for pension plans, (2) Title IV of ERISA dealing with plan termination insurance, and (3) certain tax provisions in Title II that were made inapplicable to governmental plans.
    - **ADEA, ADA, and USERRA** - Governmental plans are subject to many other provisions of federal law, including but not limited to the Age Discrimination in Employment Act ("ADEA"), the Americans with Disabilities Act ("ADA"), the Uniformed Services Employment and Reemployment Rights Act ("USERRA"), the Civil Rights Act, and the Family and Medical Leave Act ("FMLA").
- Relevant State laws affecting government plans include:

- **"Plan Document" -** State statutes (or local ordinances) establishing the defined benefit plan are generally considered to be the "Plan document." Regulations or administrative materials may amplify and assist in interpretation of the plan. In some jurisdictions, legislation authorizes the board to adopt the plan language. The plan document generally covers the benefits offered by the Plan, how the Plan is funded, how the Plan is governed, and how the assets are managed.

- **Dealing with Errors in Administration of Benefits**:
  - Under the IRC, a qualified plan is required to be administered in accordance with the written plan document.
  - Many plans have a provision requiring correction of errors: For example, common plan language often includes the following: "If, because of an error in the records, a retiree or beneficiary receives a benefit that differs from the benefit the retiree or beneficiary is entitled to receive, the plan shall correct the error."
- **Protecting a Retirement System's Qualified Status -** Most governmental retirement systems are established and maintained as qualified governmental plans under IRC §§ 401(a) and 414(d). Qualification is vitally important and ensures that 1) employer contributions are not taxable to members, 2) earnings/income are not taxed to the trust or members, 3) favorable tax treatments may be available to members upon plan distributions, and 4) employers/members do not pay employment taxes when employer contributions are made or benefits are paid.
  - Plan counsel has previously been able to determine that there plans are qualified by submitting IRS application Form 5300 to request a determination letter from the IRS that confirms the qualified status of a plan.
  - The IRS gave sponsors of individually designed governmental plans the option of electing to use:
    - Cycle C (Feb. 1, 2013 – Jan. 31, 2014) or
    - Cycle E (Feb. 1, 2015 – Jan. 31, 2016)
- However, on July 21, 2015, the IRS issued *Announcement 2015-19*, which ends the five year remedial amendment cycles for individually designed plans effective January 1, 2017. For remedial amendment cycles beginning after 2016, plan sponsors will no longer be able to apply for determination letters on their individually designed defined contribution and defined benefit plans, except for initial qualification and qualification upon termination.

**E-Discovery**

- Electronically Stored Information (ESI) – ESI refers to any information that is created electronically and commonly appears in the following formats (.pdf, excel documents, word documents, emails, instant messages, database documents, text messages, social media entries, powerpoint presentations, audio recordings, etc.). This information is commonly stored on laptops, network databases, usb drives, private or local drives, and cell phones.
- The Importance of ESI:
  - ESI is rarely, if ever, gone.
  - In general, if a pension fund is sued and the opposing party requests ESI during discovery it must be produced. Further, if a pension fund is served with an open records request that specifically asks for ESI, it also must be produced.
- 2006 Amendments to the Federal Rules of Civil Procedure (FRCP)
  - The FRCP now expressly provides for discovery of ESI
  - FRCP have been applied to regulatory responses, government investigations, litigation, etc.
  - The FRCP instills a duty to preserve potentially responsive ESI, in a reasonably usable form, if the system reasonably anticipate litigation (or investigation, etc.).

- A failure to do so can result in possible sanctions from a court or administrative hearing officer.

- Federal and certain state laws
  - Generally, federal and state case law requires, at a minimum, review of ESI to identify information responsive to a discovery request
  - Some case law in certain states now requires production in solely electronic format
  - These rules apply to governmental vendors as well

**Terminating Employers and Outsourcing Employees**

- Handling Withdrawals from Multi-Employer Public Pension Plans – This will be an issue of increasing importance as public employers deal with increased pension obligations under GASB 68. This session examined different statutory mechanisms around the county to allow employers to withdraw from public pension plans. Several common characteristics were discussed:
  - Employers have to follow the state statute to leave; they must follow a multi-step process; and the withdrawing employer has to pay accrued vested benefits of its member. Further, some plans only allow certain types of employers during certain time periods to withdraw and some allow for only partial withdrawals
  - Why do Employers want to leave? According to the panel, employers want to leave for several reasons:
    - Lower employer contributions as statewide plans become more expensive to cover shortfalls and changing demographics
    - Employers eliminate unfunded liabilities by leaving without paying
    - Recent GASB changes require recognition of unfunded liability by employers.
- Legislative and Administrative Considerations for All States in Permitting Withdrawal – All states must consider the following points when enacting or amending statutes permitting withdrawal:
  - There should be no ability to withdraw or terminate contribution obligations absent full compliance with all statutory provisions
  - There should be a trigger of withdrawal provisions by objective and subjective criteria giving deference to pension system to determine
  - The statute should address remedy for pension system and employees for an employer's failure to comply
  - It should define partial withdrawal and address privatization of portions of a workforce
  - It should include all plan obligations within withdrawal liability such as health plans and other benefits
  - It should require administrative review procedure with discretion of plan actuary
  - It should set forth actuarial assumptions to be applied to calculate withdrawal liability

**Ethics**

- Creating an Ethical Environment - An ethical environment starts with a positive "tone at the top" and organization-wide core values and policies to which all employees have buy-in. This must involve managers in all system divisions and consider bringing in outside experts when necessary. This raises the probability that your organization will operate to high standards of what is right, fair and good in all of your dealings, both internally and externally.
  - This can be done by identifying opportunities for unethical or fraudulent conduct in the system. These opportunities include: employees lying to other employees and external

stakeholders, benefits violations, falsifying time and/or expenses, document alteration, misrepresenting financial records, bribing public officials and insider trading, and employees who are reluctant to report the misconduct they observe.

- Ethical Considerations for Fund Counsel – Under ABA Rules of Professional Responsibility Rule 2.1, in representing a client, a lawyer shall exercise independent professional judgment and **render candid advice**. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation.
    - A client is entitled to straightforward advice expressing the lawyer's honest assessment. Legal advice often involves unpleasant facts and alternatives that a client may be disinclined to confront. In presenting advice, a lawyer endeavors to sustain the client's morale and may put advice in as acceptable a form as honesty permits. **However, a lawyer should not be deterred from giving candid advice by the prospect that the advice will be unpalatable to the client.**
- Federal rules barring compensation to External Investment Managers for Political contributions above the de minimis threshold
    - Federal law strives to prevent any investment adviser registered (or required to be registered) with SEC to provide investment advisory services for compensation to a government entity within two years after a contribution to an official of the government entity is made by the investment adviser or any covered associate of the investment adviser (including a person who becomes a covered associate within two years after the contribution is made).

**A Lawyer, an Auditor and an Actuary . . .**

- Implementation of New GASB Pension Standards – Under GASB Statement No. 67 and 68 requirements, employers need to determine the following pension amounts: 1) Net pension liability (asset), 2) Pension expense, and 3) Pension deferred outflows of resources and deferred inflows of resources. Employers participating in single-employer or agent multiple-employer plans recognize 100 percent of the above amounts for each plan. Employers participating in cost-sharing multiple-employer plans recognize their proportionate share of the collective amounts for the plan as a whole.

- Funding Policies in a Post-GASB World New Rules and Emerging Guidance - GASB Statements 67 and 68 make a clear separation between accounting cost (expense) and funding cost (contributions). This is in contrast to GASB Statement 25 and 27, where expense was the "ARC" (Annual Required Contribution). In the opinion of experts, Actuarial organizations and state regulatory agencies and legislatures will replace GASB's role defining, monitoring and enforcing acceptable funding policies.
- Actuarial organizations, through Standards of Practice and Reports will address aspects of funding policy. Several items that already do this are:
    - Actuarial Standards Board – Revised Actuarial Standards of Practice (ASOP) 4, which addresses some aspects of funding policy
    - Academy of Actuaries Public Plans Subcommittee – Issue Brief on Objectives and Principles issued Feb. 2014

    - Society of Actuaries "Blue Ribbon Panel Report" issued Feb. 2014
    - Conference of Consulting Actuaries Public Plans Community (CCA PPC) – Actuarial Funding Policies and Practices "White Paper" issued October 2014.
- Though actuaries may develop acceptable practices and models, they will not develop an enforcement mechanism

**DB vs Alternative Plans**

This session centered around a conversation between both advocates for and against the elimination of defined benefit plans.

- Prevailing Approaches to Public Pension Reforms – Between 2009-2013, 48 states made changes to their pension plans – some more than once. Further, 34 states increased employee contributions and 38 states instituted higher age and service requirements for retirement. 30 states reduced cost of living adjustments, and 18 states instituted steps to convert DB plans into DC or Hybrid Plans. (Mandatory Hybrid – 6 States, Mandatory Cash Balance – 3 State, Mandatory DC – 2 States, and Choice of Plan – 7 States).
- Economic Efficiencies of Defined Benefit Pensions – 3 Reasons Why DB Plans Save Money Compared to DC Plans –
    - DBs pool the longevity risks of large numbers of individuals, providing each the security of a lifetime pension without the risk of outliving their savings
    - DBs are "ageless" and therefore can perpetually maintain an optimally balanced investment portfolio rather than the typical individual strategy of down-shifting over time to a lower risk/return asset allocation
    - DBs achieve higher investment returns as compared to individual investors because of professional asset management and lower fees
- DC Plan Strength 1 – DB Plans can be funded to last the average life expectancy for each participant, however under a DC plan an individual must plan to get income beyond average, to avoid running out
- DC Plan Strength 2 - In a DC account, individuals must adjust risk as they age to protect against market shocks, shifting to more conservative investments as they age, sacrificing some expected return
- DC Plan Strength 3 – Pooled investments in DB plans can lower expenses: 1) larger group pricing negotiation and 2) avoid expenses of individual record keeping, investment education, and investment transactions

Argument for Abolishment of DB Plans – According to one presenter, DB plans leave many workers without enough retirement savings and are risky for workers and taxpayers. According to this same presenter, workers are exposed to risk when the plan sponsor fails to make sufficient payments, takes on too much investment risk, and makes incorrect assumptions about factors like life expectancy. The consequences of this risk for workers and taxpayers are cuts in retirement benefits, wages, jobs, and public services. Further, according to the presenter, not including the cost of risk to workers and taxpayers, the carrying cost of debt is about 9 percentage points of payroll for a plan with a funded ratio of 80 percent.

**Municipal Bankruptcy**

This session covered topics including the preparing for an employer bankruptcy, differences between private and public bankruptcy, advocating for the trust as a creditor, constitutional issues and current trends in the arena of municipal bankruptcy.

- Bankruptcy Considerations for Public and Pension Attorneys – There are two major areas of law that must be considered by attorneys - 1) The Supremacy Clause and Uniform bankruptcy laws
    - Chapter 9 covers the bankruptcy of municipalities and adjustment of debts.
    - Chapter 9 Bankruptcy abrogates state sovereign immunity.
- In order for a municipality to file for bankruptcy there must be state law authorization. Currently, 28 states allow for Chapter 9 bankruptcy filings to some degree, including Montana.
- Bankruptcy Code Chapter 9 Eligibility Requires – In order to file for Chapter 9 bankruptcy protection, a debtor must be: 1) a municipality, 2) specifically authorized to be a debtor under state law; 3) be insolvent, 4) desire to effect a plan to adjust its debts; and 5) obtain an agreement of creditors holding at least a majority in amount of claims in each class the entity intend to impair; or have negotiated in good faith with creditors and failed to reach an agreement; or be unable to negotiate with creditors because negotiations are impracticable; or reasonably believe that a creditor may attempt to obtain an avoidable transfer.

- Hiring the Right Professionals When Preparing for Chapter 9 Bankruptcy – A municipality must ensure they have proper legal representation with experience in municipal bankruptcy and financial restructuring, retirement benefits, municipal finance, governmental relations, and litigation and must select counsel capable of facilitating discussions at the negotiation tables and protecting the system's interests in the courtroom. Further, a municipality needs to select actuaries that understand the system and who can assist in developing creative plan re-design and also needs to select financial advisors to assist in understanding the municipality's financial situation and developing alternative restructuring strategies.

**Litigation Update**

Summary of 39 recent significant decisions regarding constitutional, fiduciary duty, service credit, salary and benefit computation, death/survivor benefits, disability benefits, refunds, employment after retirement, marital/dissolution issues, benefit forfeiture, freedom of information and open meetings.